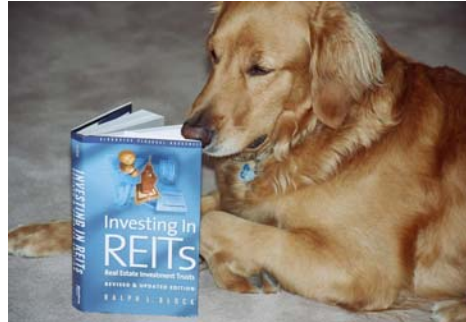


# “THE ESSENTIAL REIT”

December 1, 2004



*“Writing does for me what giving milk does for a cow.” -- H.L. Mencken*

*“Writing is not necessarily something to be ashamed of, but do it in private and wash your hands afterwards” -- Robert Heinlein*

*“Writing is like prostitution. First one writes for the love of doing it, then for a few friends, and, in the end, for the money.” – Moliere*

## 1. A REIT Forecast for 2005 (*well, sort of...*).

At least once a year an elf with a crooked smile sidles up next to me, often around the Holidays, and whispers quietly into my ear, “Reitnut, it’s time to again tweak your readers’ patience by feeding them a bit of poetry.” Well, not wanting to offend this playful creature – and there not being anything else of importance that I want to write about at the moment – I have succumbed to these persuasive blandishments once again. So here, dear reader, is another excuse for poetry, in which I seek to address some of the issues that will face Reitsters when contemplating REITs’ prospective 2005 performance. I hope you will treat this effort with generous Holiday spirit, and resist the urge to toss brickbats<sup>1</sup> at the “poet.”

Our targets all are blown away,  
Old records down the drain;  
REIT stocks have kicked some major butt,  
The shorts scream out in pain.

Like mighty airborne Supermen,  
(Disguised as mild Clark Kent),  
REITs five-year romp was off the charts –  
Averaging twenty percent.

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<sup>1</sup> NOUN: 1. A piece, especially of brick, used as a weapon or missile... Such pieces of brick have not infrequently been thrown at others in the hope of injuring them; hence, the figurative *brickbats* (first recorded in 1929) that critics hurl at performances they dislike. From [www.bartleby.com](http://www.bartleby.com).

But trees grow not into the sky,  
And stocks revert to the mean;  
So will '05 become an ugly year,  
In which Reitsters cease to preen?

My crystal ball is cloudy –  
The future's a muddled stew;  
But like those witches from Mac Beth,  
I'll stir you up a brew.

"Eye of newt and toe of frog,  
Wool of bat and tongue of dog..."<sup>2</sup>  
(Calm down, Sammy, they don't mean you) –  
Will my picture cast a too-rosy hue?

By hoary yields and multiples standards,  
REIT stocks appear quite pricey;  
But comparisons with NAVs  
Show values far less dicey.

So private market pricing is  
A key to this complex puzzle;  
Are pension funds now satisfied,  
Or do they voraciously still guzzle?

Are prevailing market cap rates  
Unrealistically rich and low?  
Will they turn back up perversely,  
Striking our REITs a painful blow?

"It's never, ever different this time,"  
Our cyclicalists intone;  
"When interest rates begin to rise,  
The low cap story's blown."

"But wait," say smiley secularists,  
"Our world's more warm and sunny;  
Allocations still are much too light –  
Just follow well the money."

You may label me a wussy waffler,  
My view's betwixt those two;  
Rising rates can be a pain,  
But pricing's a complex stew.

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<sup>2</sup> "Eye of newt, and toe of frog,  
Wool of bat, and tongue of dog,  
Adder's fork, and blind-worm's sting,  
Lizard's leg, and howlet's wing,--  
For a charm of powerful trouble,  
Like a hell-broth boil and bubble."

Yet hedgies and their fellow traders  
Can morph quickly into bears –  
When long rates start to escalate,  
They'll barf out all their shares.

Our REITs, of course, are divinely blessed  
With sweet cash flow stability;  
But the traders in control today  
Spawn frightful volatility.

Do rising volumes of IPOs  
Mean a REIT bull market peak?  
Though aggressive pricing is the norm,  
After-markets have been weak.

There's no portentous feeding frenzy  
That's easy to discern;  
At NAREIT's conference in LA  
Our countenances were stern.

The sell-side guys all sport big claws,  
"Reduce your REITs," they say;  
Irrational exuberance  
Seems many months away.

Now let's review the sectors –  
Which performs the best?  
That, good sir, is a loser's game,  
A Holy Grail quest.

Let's label most of the office REITs  
Soporific Ambien Hounds;  
Occupancy gains will be offset  
With nasty rental roll-downs.

The picture's brighter for industrial REITs,  
But, oh, what a heart-rending pity –  
Avaricious merchant builders  
Are becoming downright giddy.

Apartment owners finally emerge  
From a pit both cold and deep;  
But if more jobs are not created,  
Cash flow growth won't leap.

If gasoline spikes and home prices fall  
I'll look like an abject fool;  
But I'm inclined to tell the retail boys,  
"Party on, dudes – it's cool."

Assume just minor cap rate moves,  
Modest tweaks to NAVs;  
And that investors still love dividend yields –  
Thus no change to REITs' P/Es.

Let's posit 4 percent AFFO growth –  
I hope you don't dissent –  
Tack on a 5% dividend yield,  
Our returns could be nine percent.

What's the joker in the deck  
That could really foul our year?  
If the 10-year crosses five percent  
We'll be crying in our beer.

Do I strongly believe in this forecast?  
Can we take it to the bank?  
Sit down, son, and brace yourself,  
I'll be humble, fair and frank.

Every year in the investment world,  
Come demons from hellish portals;  
They love to ruin the best-laid plans  
Of us poor and chastened mortals.

So nail down your REIT allocations,  
Decide what is right for you;  
Understand well this asset class,  
And plod on with a long-term view.

If you deem any of the foregoing nonsense helpful I'll be very disappointed in you. Seriously, though, I will try to engage you in a more thoughtful discussion of what might lie ahead of us in '05 with the next issue in late December. Meanwhile, here's wishing you and your loved ones a very happy and healthy Holiday Season!

Best regards,  
Ralph (Block)

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